

BEFORE THE POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

Periodic Reporting (UPS Proposal One)

Docket No. RM2020-9

COMMENTS OF PITNEY BOWES INC.
(December 15, 2020)

Pursuant to Order No. 5738, Pitney Bowes Inc. (Pitney Bowes) respectfully submits these comments in response to Proposal One of United Parcel Service, Inc. (UPS).¹

The Postal Regulatory Commission (Commission) should reject UPS's proposal to assign approximately \$500 million of "unexplained" peak-season costs to competitive products. First, UPS's proposal proceeds from the flawed premise that the existing models do not capture seasonal variations in product unit costs. Second, UPS assumes incorrectly that competitive products are the only products with higher volumes and costs during peak season; this assumption ignores substantial peak increases in First-Class Mail and international mail. Third, the *ad hoc* non-causal method UPS proposes for assigning additional costs to competitive products as a group would violate the statutory causation requirement by attributing costs to products that do not cause those costs. The Postal Service should continue to analyze seasonality effects and to refine the cost models to make improvements to account for seasonal costs.

I. UPS's Proposal Fails to Recognize that the Existing Costing Models Already Account for Seasonal Variations in Costs

UPS bases its petition on the argument that the costing models used by the Postal Service were designed for letter mail, not packages, thus, the costing models do not accurately capture costs and

¹ See Petition of United Parcel Service, Inc. for the Initiation of Proceedings to Make Changes to Postal Service Costing Methodologies (May 29, 2020) (UPS Petition).

seasonal patterns unique to package delivery services. *See* UPS Petition at 1-2. UPS’s argument is wrong on multiple levels.

As an initial matter, because the Postal Service is a multi-product firm, the costing system is designed to capture the costs of products of all shapes, not just letter mail products.² As the Postal Service’s product mix changes, the changes are captured by the distribution keys embodied in the sampling systems, including the Transportation Cost System (TRACS), the In-Office Cost System (IOCS), and the City Carrier Cost System (CCCS), among others to distribute costs to products.

Contrary to UPS’s suggestion that the “legacy” costing models are static, UPS Petition at 1, the costing system has also evolved through a participatory and transparent regulatory process. The costing system is subject to continuous review, refinement and improvement, including ongoing studies to investigate seasonal costs.

UPS is also incorrect in asserting that the Postal Service has historically “focused almost exclusively on delivering letters.” *Id.* For over 100 years, the Postal Service has been a significant player in the package delivery market. Congress directed the Postal Service to introduce Parcel Post in 1913 to inject competition into the package delivery market and to correct for the abuses of private carriers.³ Congress reaffirmed the Postal Service’s role as a competitor in the package delivery services business in the 1970 Postal Reorganization Act and in the Postal Accountability and Enhancement Act (PAEA) of 2006.

² *See e.g.*, Office of Inspector General, United States Postal Service, *A Primer on Costing Issues*, Rept. No. RARC-WP-12-008 (Mar. 20, 2012) (citing testimony of well-known economists Baumol, Panzar, and Vickery); Office of Inspector General, United States Postal Service, *Examining Changes in Postal Product Costs*, Rept. No. RARC-WP-17-005 (Mar. 13, 2017) (publishing Technical Report of Dr. Michael Bradley on “Measuring the Sources of Change in the Postal Service’s Product Costs”).

³ *See* Office of Inspector General, United States Postal Service, *100 Years of Parcel Post*, Rept. No. RARC-WP-14-004 (Dec. 20, 2013).

More fundamentally, UPS is wrong when it asserts that the current models do not account for seasonal variations in costs. The Commission considered and rejected similar arguments from UPS in Docket No. ACR2018:

This conclusion by UPS that seasonal trends are not reflected is incorrect. This assertion overlooks the fact that the Commission’s costing methodology is designed to estimate costs on an annual basis, so any seasonal differences are captured in the annual totals. Distribution keys for costs are created on a quarterly basis—to the extent that parcel volume is greater in one quarter than in others, the current methodology incorporates and reflects those data.⁴

As Dr. Bradley explained at the September 29 Technical Conference, the variabilities and distribution keys may be different for seasonal costs, but the established costing methodologies for measuring variable and incremental costs are the same. Thus, the established incremental cost methodology “accounts for peak season costs by including the relevant seasonal volume variable, product specific, and inframarginal costs in each product’s incremental costs.”⁵

As Dr. Bradley further explained, UPS’s failure to recognize the fact that seasonal costs are already included in the accrued cost base used for calculating product costs leads to inaccurate results. Specifically, the UPS proposal overstates peak season institutional costs that it characterizes as “unexplained” costs, while simultaneously understating peak season volume variable costs.⁶

Finally, even if UPS were correct that there were \$500 million in “unexplained” peak costs, the suggestion that the issues raised by the petition call into question “whether the Postal Service’s package delivery business is actually profitable” is unserious. UPS Petition at 5. In FY2019 the contribution of competitive package services, above costs, was \$8.2 billion.⁷ The contribution from

⁴ PRC Docket No. ACR2018, Annual Compliance Determination Report for Fiscal Year 2018 (Apr. 12, 2019) at 121 (citations omitted).

⁵ Response of the United States Postal Service to Order No. 5687 Regarding Technical Conference Material (September 28, 2020), Seasonal Volume Variations and Product Costing, Prof. Michael D. Bradley (Bradley Presentation) at 15-16.

⁶ See Bradley Presentation at 18-22.

⁷ See PRC Docket No. ACR2019, Annual Compliance Determination Report, Fiscal Year 2019 (March 25, 2020), at 86.

competitive package products will almost certainly be even greater in FY2020. Ensuring attributable costs are as accurate as possible is a shared goal of all postal stakeholders, but it is not credible for UPS to allege that its petition raises material compliance or competition policy issues. UPS's claims are also directly contradicted by the Commission's most recent annual compliance determination which affirmatively held, like every prior Commission annual compliance determination since 2006, that the Postal Service's competitive package business is operating in compliance with the law and is contributing positively to the Postal Service's financial condition.⁸

II. UPS's Proposal Ignores That Other Products, Including First-Class Mail and International Mail, Also Peak in December

UPS's proposal to assign \$500 million in "unexplained" peak costs to competitive products incorrectly assumes that competitive products are the only products with higher volumes during peak season. As above, the Commission has previously considered and rejected similar arguments by UPS in the past:

The Commission also notes that demand for both Competitive and Market Dominant products increases during peak season, and, as a result, seasonal increases in costs are not exclusively attributable to Competitive products.⁹

UPS attempts to sidestep the Commission's prior findings by presenting "aggregated" December mail volume spikes for Marketing Mail and First-Class Mail combined. UPS Petition at 16-18. This approach has the transparent effect of pulling seasonal mail volume spikes earlier in time because Marketing Mail volumes often peak in October and November, rather than December. UPS also attempts to evade the Commission's prior findings by arguing that competitive products experience the "greatest peak" as measured by a percentage change in volume from November to December. UPS Petition at 15. As Dr. Bradley explained, however, a comparison of percentage

⁸ See *id.*, at 70, 72.

⁹ PRC Docket No. ACR2018, Annual Compliance Determination Report for Fiscal Year 2018 (Apr. 12, 2019) at 121 (citing USPS elasticity regression estimates).

changes can provide a misleading sense of relative importance of seasonal volume peaks.¹⁰ For example, Dr. Bradley’s presentation demonstrated that the absolute volume growth in First-Class Mail is many times larger than the growth in competitive products and that the percentage change in international mail exceeds the percentage change in competitive products.¹¹ Dr. Bradley’s presentation thus confirmed the Commission’s prior findings that while competitive volumes contribute to seasonal peak costs, they are not the sole cause of seasonal increases in costs.

III. UPS’s Proposal is Unsupported by Reliable Evidence of Causation and, thus, Cannot be Adopted

The UPS Petition must also be rejected because the *ad hoc* non-causal method UPS proposes for assigning additional costs to competitive products would degrade, rather than improve, existing costing methodologies and would violate the statutory causation requirement by attributing costs to products that do not cause those costs. For the reasons stated above and in Dr. Bradley’s presentation, UPS’s calculation of “unexplained” peak costs is invalid. Even if the calculation of “unexplained” peak costs were correct (it is not), it would be improper to assign these costs entirely to competitive products as a group because they were not solely caused by competitive products. It would also be improper to allocate the “unexplained” costs assigned to competitive products as a group to individual competitive products on a *pro-rata* basis by weighted volume. *See* UPS Petition at 40. In fact, the Commission has repeatedly rejected similar UPS proposals to adopt approaches that would produce outcomes “tantamount to fully-allocated costing” because such approaches would “result in costs being allocated to specific products or groups of products on a basis other than casual relationships” as required by the PAEA.¹² Assigning these costs to competitive products in the manner proposed by UPS would not “improve the quality, accuracy, or completeness” of an existing costing methodology

¹⁰ *See* Bradley Presentation at 7-9.

¹¹ *See id.*

¹² PRC Docket No. RM2017-1, Order No. 4963 (Jan. 3, 2019) at 35-36 (citing PRC Docket No. RM2017-1, Order No. 4402 (Feb. 8, 2018) at 81-82); *see also* PRC Docket No. ACR2018, Annual Compliance Determination Report for Fiscal Year 2018 (Apr. 12, 2019) at 121.

as required by 39 C.F.R. 3050.11(a). Adopting UPS's proposal would also violate the statutory causality standards in 39 U.S.C. §§ 3622(c)(2), 3631(b), and 3633(a)(1) and (2) by attributing costs to products that do not cause those costs.

IV. The Postal Service Should Continue to Analyze Seasonality Effects and Refine the Cost Models where Appropriate

Notwithstanding the flaws in the UPS proposal, the petition draws attention to the importance of studying seasonal costs. It was encouraging to hear Dr. Bradley outline a number of studies that are being planned or have already been initiated by the Postal Service to investigate seasonal costs.¹³ The Commission should encourage the Postal Service to pursue those studies and report the results under established Commission procedures.

V. Conclusion

For the reasons stated above the Commission should decline to adopt UPS Proposal One.

Respectfully submitted:

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¹³ See Bradley Presentation at 23-26.